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DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA-SEARLS
SINGAPORE FOR TREASURY-BAKER
COMMERCE FOR 4430-BERLINGUETTE
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR FINEMAN
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - ECONOMIC AND FINANCIAL HIGHLIGHTS MARCH 2007

11. Summary. On April 2, the Central Bureau of Statistics (BPS) announced that consumer price inflation rose a modest 0.24% in March on a month-on-month (MoM) basis as rice price increases moderated. Three days later, Bank Indonesia (BI) announced it would keep its benchmark 30-day Bank Indonesia Certificate (SBI) rate unchanged at 9% after ten interest rate cuts totaling 375 basis points over the past 11 months. The rupiah remained generally stable in March in the wake of February's emerging market volatility, appreciating by 0.5% against the U.S. dollar. The Jakarta Stock Exchange (JSX) composite index rose by 5.2% over the same period. Minister of Finance Sri Mulyani Indrawati told a Parliament hearing on March 22 that the Government of Indonesia (GOI) is considering increasing the 2007 budget deficit to an amount equivalent to 1.5 - 2% of Gross Domestic Product (GDP), up from 2006's 1.1% of GDP target. On March 20, the Ministry of Finance (MOF) raised Rp 9.2 trillion (\$1 billion) from an auction of 10- and 15-year government bonds in which 18 newly-appointed primary dealers participated for the first time. On March 26, the MOF offered Rp 6.2 trillion (\$680 million) of its popular three-year retail bonds to the public. Effective March 22, the Indonesian Deposit Insurance Corporation (LPS) reduced its insurance coverage to Rp 100 million (\$10,970) per depositor per bank, the final step in the GOI's rollback of its blanket bank guarantee. Several major Indonesian banks issued their 2006 financial statements in March 2006, most of which showed increased profitability and improved asset quality. Former Australian Prime Minister and Treasurer Paul Keating called on the GOI to give up its ownership in banks at the March 25-28 eighth annual Asian Banker Summit in Jakarta. However, on March 26, state-owned Bank Negara Indonesia's (BNI) President Director Sigit Pramono confirmed the postponement of plans to sell a stake in the bank while the GOI awaits Parliamentary approval. This cable uses an exchange rate of 9,118/USD. End summary.

Stable Markets in March

12. On April 2, the Central Bureau of Statistics (BPS) announced that consumer prices in March rose a modest 0.24% on a month-on-month (MoM) basis as rising rice prices continued to abate. On a yearly basis, however, inflation in March 2007 stood at 6.62%, higher than the 6.3% recorded in February. The BPS announced that core inflation for the month was 0.17% MoM, and 5.87% year-on-year (YoY). BPS director Rusman Heriawan noted that the price of the country's main staple, rice, was now causing less concern. "Rice

prices are now giving rise to weaker inflationary pressures. We are seeing prices stabilize, and even fall slightly," he said.

Table 1: Consumer Price Inflation
Components - March 2007

Component	March	
	MoM	YoY
Foodstuffs	0.24	11.97
Prepared food, beverages, tobacco	0.36	6.05
Housing, water, electric, fuel	0.29	5.04
Clothing	0.41	5.90
Health	0.20	5.38
Education, recreation/sports	0.03	8.48
Transportation, communication and financial services	0.09	1.00
Total	0.24	6.52
Core Inflation (1)	0.17	5.87

(1) Core inflation is a measure of inflation which excludes certain items that face volatile price movements i.e. energy, food products.

Source: Central Bureau of Statistics (BPS)

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13. Despite signs of moderating food prices, BI kept its benchmark interest rate unchanged at 9% at its April 5 monetary policy board meeting, after a 25 bps cut on March 6. In a statement released after the meeting, BI Governor Burhanuddin Abdullah noted that at this time, "monitoring of prices in the administered prices, staple goods and volatile foods categories and other macroeconomic indicators point to the need for a closer watch on the possibility of a future rise in inflation. Public expectations of inflation are also predicted to follow an escalating trend in line with the improving outlook for domestic demand in response to increased economic activity." BI expects this year's inflation to be between 5-7%, with the key BI rate falling to 8.5% by the end of the year. The favorable inflation figures boosted local capital markets, with the JSX Composite Index rising 1% to 1,849 on April 2. Following emerging market volatility in February, the rupiah remained generally stable in March, strengthening by 0.5%. The rupiah was bolstered by improved performance in the balance of payments, and the continued attractiveness of yields on rupiah debt instruments. The JSX composite index improved by 5.2% in March over February.

GOI to Run Larger 2007 Budget Deficit

14. During a March 22 discussion, Chairman of the Parliament's budget commission Emir Moeis and Finance Minister Mulyani said that the GOI may widen the 2007 state-budget deficit to an amount equivalent to 1.5 - 2% of GDP, or Rp 55.2 - 73.6 trillion (\$6.1 - 8.1 billion). The 2007 budget passed by Parliament projected a deficit of Rp 40.5 trillion (\$4.4 billion) or 1.1% of GDP. On April 11, Mulyani reportedly stated the GOI would use the additional funds to rebuild after the earthquakes in West Sumatra and Yogyakarta, repair damage from flooding in Jakarta and the Sidoarjo mudflow in East Java, and boost domestic rice output by 2 million tons. She reportedly added that the GOI might need additional funds to increase support to state electricity company PLN. However, Mulyani noted that the GOI would not announce an official figure until after discussions with the Parliament. Deficit financing will likely come from domestic and global U.S. dollar bonds. According to MOF Director General for Debt Management Rahmat Waluyanto, the GOI can safely finance the additional deficit assuming it raises Rp 3 trillion, or \$330

million, per month from bond auctions. To date this year, the MOF has raised Rp 32.8 trillion (\$3.6 billion) from rupiah-denominated bond auctions and swaps.

Government Bond Market Update

15. On March 20, the MOF raised a total of Rp 9.2 trillion (\$1 billion) from several bond auctions, including Rp 4.1 trillion (\$450 million) from the sale of 10-year bonds and Rp 5.1 trillion (\$560 million) from selling 15-year bonds. The 10 and 15-year bonds offer 9.9% and 10.4% yields, respectively. For the first time, Indonesia's newly appointed primary dealers participated in the auction. On December 29, 2006 Finance Minister Sri Mulyani Indrawati signed Ministerial Decree No. 144/2006 establishing Primary Dealer System for rupiah-denominated government securities.

Table 2: Indonesia's Primary Dealers:

-- Citibank N.A.
-- Bank Lippo
-- Deutsche Bank AG
-- Bank Mandiri
-- HSBC
-- Bank Negara Indonesia
-- Bank Central Asia
-- Bank Panin
-- Bank Danamon Indonesia
-- Bank Rakyat Indonesia
-- Bank DBS Indonesia
-- Bank Permata
-- Bank Internasional
-- Standard Chartered Bank Indonesia
-- Bahana Securities
-- Mandiri Sekuritas
-- Danareksa Sekuritas

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-- Trimegah Securities

16. On March 26, the MOF offered for the second time Rp 6.2 trillion (\$680 million) of its popular retail bonds to the public. The 3-year retail bonds carry a 9.3% annual coupon rate. The government sold its first Rp 3.3 trillion (\$362 million) of retail bonds in August 2006, in an action many analysts termed a big success. Director General for Debt Management Rachmat Waluyanto told the media "there was strong demand for a second retail bond due to expectations of a downtrend in interest rates until the end of the year."

Final Roll-Back of Blanket Guarantee

17. Effective March 22, the Indonesian Deposit Insurance Corporation (LPS) reduced its deposit insurance coverage to Rp 100 million (\$10,970) per depositor per bank, the final step in the GOI's reduction of its blanket bank guarantee. The move appeared to cause no disruption to the banking sector, although some large depositors divided accounts inside a single bank, moved them to larger banks, or distributed money among different banks.

Indonesia Hosts Asian Bankers Summit

18. Banking leaders from Asia, Europe, U.S. and Australia participated in the eighth annual Asian Banker Summit on March 25-28 in Jakarta. Over 500 banking professionals from more than 24 countries exchanged ideas on regional and global issues at the three-day summit, according to the Indonesian Bank Association Chairman Sigit Pramono. In his keynote speech at the summit, BI Governor Burhanuddin Abdullah said Indonesia's banking sector has come a long way since the crisis, when the government was forced to inject huge amounts of public funds into the industry to prevent its collapse. Many bankers attending the event acknowledged that Indonesia's

banking sector has recovered from the crisis. Summit director Fiona Shaw said the Indonesian banking sector had made tremendous progress since 1997 through a series of mergers, acquisitions, consolidations and fairly successful micro-financing schemes. "We decided to pick Jakarta (for the summit venue) because we thought it was time to showcase the progress to the rest of the world," Shaw said.

¶9. Former Australian Primer Minister and Treasurer Paul Keating, however, said that Indonesia needs to give up government ownership of banks and improve its risk management capabilities. "Governments should steer the boat, not row the boat," focusing on regulation rather than ownership, he noted. Government ownership of banks creates unhealthy risk within the industry and could jeopardize the state budget, Keating reportedly said, because bank management assumes the government will step in if they find themselves in trouble. Private capital is generally more careful about loan quality, Keating reportedly added.

BNI Divestment Delayed

¶10. On February 25, a member of Parliament's Working Committee on Privatization announced the committee would delay a decision on whether to divest a portion of state-owned Bank Negara Indonesia (BNI), Indonesia's third largest lender. The GOI reportedly wanted to sell 20% of BNI's shares in the first-phase of the planned divestment, while a number of members of the Working Committee demanded that the divestment be limited to 15% of the bank's shares. "The decision of the Committee is based on 2007 State Budget," Anna Mu'awanah, a member of the Working Committee from the National Awakening Party Faction, told reporters. However, Sugiharto reportedly said that the resolutions of the Working Committee "could still be altered." Finance Minister Sri Mulyani Indrawati said she hoped that the BNI share offering could contribute substantially to privatization proceeds in 2007. On March 26, BNI President Director Sigit Pramono confirmed the postponement, which comes as the GOI is awaiting Parliamentary approval for its plans to sell stakes in 15 state-owned enterprises to meet an expanded 2007 privatization target of Rp 4.3 trillion (\$471.6 million), up from Rp 3.3 trillion (\$361.9 million) in the current budget.

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Table 4: Selected Economic, Financial, and Trade Statistics, December 2006 - March 2007

	Dec	Jan	Feb	Mar
CPI Inflation (YoY)	6.60	6.26	6.30	6.52
CPI Inflation (MoM)	1.21	1.04	0.62	0.24
Rp/USD Exch. rate(1)	9,020	9,090	9,160	9,118
30-day SBI rate (1)	9.75	9.50	9.25	9.00
Foreign Res. (\$ bn)(1)	42.6	43.3	45.7	47.2
JSX Composite Index(1)	1,805	1,757	1,741	1,831
Exports (\$ billion)	9.5	8.4	8.3	
Percent change (YoY)	16.9	10.5	11.5	
Imports (\$ billion)	4.9	5.2	4.7	
Percent change (YoY)	5.9	19.5	11.1	
Trade Balance	4.6	3.2	3.6	

Source: Bank Indonesia, BPS, JSX
(1) End of period

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